

**LEGISLATIVE SERVICES AGENCY
OFFICE OF FISCAL AND MANAGEMENT ANALYSIS**

301 State House
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FISCAL IMPACT STATEMENT

LS 7225

BILL NUMBER: HB 1397

DATE PREPARED: Jan 28, 2002

BILL AMENDED:

SUBJECT: Tax exemptions and credits.

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FUNDS AFFECTED: ☒ **GENERAL**
☒ **DEDICATED**
FEDERAL

IMPACT: State & Local

Summary of Legislation: This bill exempts from property tax certain inventory used to produce finished goods that qualify for interstate commerce exemptions. It establishes a credit against state tax liability, phased in over ten years, based on property tax paid on inventory not eligible for the exemption. The bill also exempts research and development equipment from the state Gross Retail Tax.

Effective Date: January 1, 2003.

Explanation of State Expenditures:

Explanation of State Revenues: *R & D Equipment Sales Tax Exemption:* This bill exempts certain expenditures made after January 1, 2003, on research and development (R&D) equipment from the state Sales and Use Tax. This exemption is estimated to reduce Sales Tax revenue by **\$11 M to \$22 M in FY 2003**, and by approximately **\$26 M to \$52 M** in subsequent years.

Gross Retail (Sales) and Use taxes are deposited in the state General Fund (59.03%), the Property Tax Replacement Fund (40.0%), the Public Mass Transportation Fund (0.76%), the Commuter Rail Service Fund (0.17%), and the Industrial Rail Service Fund (0.04%).

Methodology: The estimate above is based on data obtained from the National Science Foundation that provide the total value of industrial research and development performed in Indiana. Based on 1998 data, adjusted for inflation, it was estimated that by CY 2003 and CY 2004, Indiana firms will expend approximately \$3,076 M each year on R&D. The share of the estimated total expenditures subject to the Sales Tax was then estimated using R&D information on the type of expenditures made in the United States. Based on these data, it was estimated that approximately 17% to 34% of Indiana R&D expenditures would be subject to the state's 5% Sales Tax.

Production Inventory State Income Credit: Under this provision, a taxpayer would be eligible for a state tax credit against a portion of the property tax paid on production inventory. The credit would begin at 10% in CY 2003 and increase by 10% annually until it reaches 100% in 2012. The credit would remain at 100% in all years after 2012.

Based on the net property tax on production inventory, calculated after the exemption in this bill is applied, the cost of the credit is estimated at \$3.8 M in CY 2003, \$7.8 M in CY 2004, and \$11.9 M in CY 2005. When fully implemented at 100% in CY 2012, the cost is estimated at \$43.6 M.

The credit may be taken against a taxpayer's Corporate Gross Income Tax, Adjusted Gross Income Tax, Supplemental Net Income Tax, Insurance Premium Tax, or Financial Institutions Tax liability. If the amount of the credit exceeds the taxpayer's liability, the excess credit may be carried forward in subsequent years. A taxpayer is not entitled to a carryback or a refund of any unused credit. If a pass through entity does not have income tax liability, the credit may be taken by shareholders or partners in proportion to their distributive income from the pass through entity.

The state revenue reduction as a result of this credit is estimated at **\$3.8 M in FY 2004 and \$7.8 M in FY 2005**. Revenue from the taxes listed above is deposited in both the General Fund and the Property Tax Replacement Fund.

Production Inventory Property Tax Exemption: The State levies a small tax rate for State Fair and State Forestry. A \$7.3 B reduction in the assessed value base will reduce the property tax revenue for these two funds by about \$240,000 annually.

Explanation of Local Expenditures:

Explanation of Local Revenues: *Production Inventory Property Tax Exemption:* Under this proposal, some inventory that is not finished goods could be exempt from property taxation. The inventory would have to be used in the production of finished goods that might qualify for an interstate commerce exemption. The percentage of production inventory that would be exempt is equal to the proportion of a taxpayer's finished goods that qualify for an interstate commerce exemption.

The 2002 Pay 2003 net inventory assessed value (AV) is estimated at \$23 B. Manufacturers account for about 40.7% of net inventory AV, or an estimated \$9.4 B AV for pay 2003. According to exemption data from the 1997 personal property tax returns, about 78.4% of manufacturers' finished goods were destined out-of-state and therefore exempt. Applying this same percentage to the rest of manufacturer's inventory, it is estimated that about \$7.3 B AV per year would be exempted by this bill.

Additional exemptions reduce the assessed value tax base. This causes a shift of the property tax burden from the taxpayers receiving the deductions to all taxpayers in the form of an increased tax rate. The above reduction in assessed value would result in an estimated net tax burden shift of about \$140 M annually.

Total local civil unit revenues, except for cumulative funds, would remain unchanged. The revenue for cumulative funds would be reduced by the product of the fund rate multiplied by the deduction amount applicable to that fund.

State Agencies Affected: Department of Local Government Finance (State Tax Board); Department of State Revenue .

Local Agencies Affected: County and township assessors.

Information Sources: National Science Foundation, *Survey of Industry Research and Development*.